DEPARTMENT OF STATE

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LDC TRADE/AID/DEBT:
Major Issues in U.S. - LDC Economic Relations

U.S. Interests

Economic relations with the LDC's impact upon three primary areas of national interest:

1. LDC raw materials, petroleum and export markets are of direct and increasing importance to the U.S. economy and strategic posture.

2. The stability of the international financial and trading system, with attendant benefits to the US, are in jeopardy as long as payments imbalances accumulate at current rates and LDCs bear the brunt.

3. Economic problems and our response to them affect the political alignment of numerous LDC's that are important to the U.S. for geopolitical and other reasons.

Discussion

The present memo will emphasize aid, trade and financial relations with the LDC's, leaving discussions on energy and on "Global Negotiations" for separate treatment.

A. Problems:

Economic relations with the LDC's in the 1980's promise to be troubled and dominated by rising oil prices and worsening global prospects. Most of the non-oil LDC's weathered the oil price increases of 1973-74, in part by heavy commercial borrowing, but they are badly positioned for the 1980's. Most have yet to begin seriously the needed adjustments. On average, LDC's now spend 46% of export earnings for oil and debt service alone. It is estimated that current account deficits in these countries will total $61 billion in 1980 (vs $6.7 billion in 1973). Net private investment flows will cover only a small portion ($6.5 billion). Furthermore non-oil LDC's have already accumulated high levels of external debt, much of it due over the next few years. Slower growth in industrial countries -- in itself a reflection of energy costs and payment imbalances-- will diminish LDC ability to expand exports; and this will be weakened further by the limits to industrial-country assistance that might finance investment in export-related industries.

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The prospects are thus for lower growth in LDCs with some of the poorest countries experiencing negative growth, widespread hardship, and social and political unrest. Inevitably, they will decelerate imports from the U.S. and its industrialized allies. Furthermore, international financial stability is threatened by the large and persistent financial imbalances that obtain among these countries.

Although the immediate financial problem is largely of OPEC's making (the LDC oil import bill this year is $67 billion), OPEC to date has offered only a small part of the solution. Total ODA flows in 1979 amounted to $28 billion. Of this, $22.3 billion came from OECD countries ($4.6 billion from the US.). OPEC's contribution was $4.7 billion. Nevertheless, the present trend is for the LDC's as a whole to band together and demand that solutions be provided largely by the OECD countries and by institutions that we control and finance. Although these demands are often unrealistic, particularly as articulated in many of the U.N. fora, the U.S. is made to appear negative and unresponsive to LDC interests. While this does not directly damage our bilateral relations with most LDC's (given the differences between what they say for the record in these fora and what they do in practice), our inability to come up with adequate assistance in specific cases often does hurt.

Congress is increasingly reluctant to vote for economic assistance or for other measures to help LDC's. Current U.S. non-military assistance has fallen to about 0.2% of GNP, whereas it had been 0.5% in the 1960's and about 0.3 % in the first half of the 1970's. Furthermore, protectionist pressures threaten to diminish LDC access to the U.S. market.

Although it is neither realistic nor desirable for the U.S. to attempt to satisfy unreasonable LDC demands, it is nevertheless important to support our legitimate bilateral interests, and to do what is feasible to reverse the slippage in U.S. prestige among the LDC's. Currently our exports to LDC's are expanding faster than our sales to developed countries and our dependence on them for imports is growing rapidly. It is thus in our interest to do what we can to help improve economic prospects for the LDC's in the 1980's. In the process, we can strengthen U.S. export and investment opportunities and develop more secure sources of supply for essential raw materials or their derivatives.

B. Repairing and Sharpening the Tools:

While space precludes detailed individual treatment of the available policy tools, the forseeable difficulties of the 80's warrant a brief review of their present state of repair:

1. Aid--relatively small and decreasing bilateral and multilateral U.S. assistance (in real terms); increasing Congressional skepticism; increasing criticism of U.S. development assistance performance by other donor countries and by LDC's; inadequate latitude for rapid deployment of bilateral aid funds for political, strategic, or other special purposes; IBRD and regional banks functioning well ($14 billion in loans in 1979), but in need of substantial replenishments, which face trouble in Congress; OPEC reluctant to give more without getting greater control.

2. Financial--IMF has expanded its role in the recyclying/adjustment process, providing more financing over longer periods; Fund will coordinate more closely with IBRD; but key to Fund/Bank success is access to sufficient resources; IMF quota increases and new plans for borrowing (primarily from OPEC) are thus important. Commercial bank exposure is high in many LDC's, especially the ADCs, thus retarding the extension of new credits; the IFIs' role is thus more crucial than in recent past; U.S. debt policy is strained by new circumstances and increasingly hard to implement in"special" cases; a flexible U.S. capability for bilateral balance of payments support is needed to supplement Bank/Fund efforts.

3. Trade--GSP running into increasing problems with "sensitive" domestic industries; a relative handful of successful LDC's getting lion's share of benefits; little present prospect of doing more for the needier LDC's.

4. Commodities--U.S. belongs to useful price stabilization agreements in sugar, coffee, tin and natural rubber; prospects reasonably good for agreement in the near future on a new, improved tin agreement; Common Fund might also eventually help finance such agreements; possible U.S. participation in market development arrangements in some products (cotton, jute, tropical timber); otherwise relatively few opportunities for additional steps that would make sense, despite LDC demands.

5. Export Financing--increasing subsidy costs for Exim to be competitive with OECD counterparts; OECD negotiations (to decrease subsidy element) apparently stalemated; insufficient funding ceiling to permit Exim to compete effectively.

6. Private Investment--insufficient advantages to balance risks in many LDC's which need it most; present $1000 per capita limit on OPIC guarantee authority for advancing LDC's diminishes attractiveness of investment there.

7. Concerted Action--N/S dialogue in U.N. fora largely stalemated, and risks doing U.S. interests more harm than good; shift to greater use of small, pragmatic groups

to tackle specific problems seemingly impossible to achieve in U.N. context; potential for use of specialized fora not fully exploited; intra-OECD coordination so far inadequate.

C. Differentiating Among LDC's:

For most purposes, the LDC's cannot be discussed as a single group except at a very high level of generality. One useful categorization is: (a) oil-surplus LDC's, (b) advanced developing countries (c) mid-level LDC's, and (d) low-income LDC's. The main economic policy tools discussed above obviously have differing relevance to each of the above LDC categories.

(a) The oil-surplus LDC's are of obvious strategic importance. Enhancing the supply and influencing the price of petroleum will of course remain an overriding goal. In addition, they present special opportunities as export markets and, in some cases, for mutually beneficial private investment in both directions. With more concerted effort to enlist the private sector via stronger export incentives, possibly including expanded OPIC guarantees and more use of the Trade and Development Program, the U.S. should be able to strengthen its economic ties with these countries--although the constraints will remain severe until there is further progress on the Arab-Israeli dispute.

A third major area for new efforts might be more effective recycling and increased development assistance from the surplus countries. Although the OPEC Fund and various specialized and/or bilateral assistance facilities have been established, a very large proportion of the oil surplus has gone to commercial banks in the industrialized countries. Some of the money is then relent to the LDC's, largely to a few of the most promising on relatively short term, and necessarily at rates that reflect the high interest paid to attract these deposits. This suggests continued U.S. efforts to persuade oil-surplus countries to do more by way of concessional assistance, as well as facilitating IMF and MDB lending on harder terms. Once the dust settles from the Iran-Iraq war, there may be new opportunities to pursue improved burden-sharing in IFAD (International Fund for Agricultural Development), special OPEC contributions to a World Bank energy facility, etc.

(b) The advanced developing countries (ADC's) also represent large and growing opportunities for U.S. exports and investment. Here too, export financing and investment guarantees are especially relevant tools. And, while most of these countries are not ready to join the ranks of net aid donors, some should "graduate" out of the ranks of MDB aid recipients in order to free resources more sorely needed by poorer LDC's--obviously a delicate issue. Equally sensitive and complex is the problem of

their trade with the U.S. Their exports are growing rapidly, and tend to include a number of sensitive items (e.g. shoes, color televisions, textiles). How we respond to the protectionist pressures this situation provokes will have an important bearing on U.S. political relations with these countries as well as our economic interests. The renegotiation in 1981 of the Multifiber Arrangement which regulates much of international textile trade is the biggest example of this problem.

Moreover, the ADC's have taken the lion's share of the benefits of U.S. trade preferences (GSP) (see attached table). While attempting to "graduate" some of them will not necessarily increase GSP opportunities for the less prosperous LDC's, it will probably be necessary in order to make the program politically less controversial. Graduation from MDB lending will also be an issue for some ADC's, and certain ADC's also present serious problems on both official and commercial debt, including massive amounts owed to U.S. banks. One need only mention Brazil, Mexico, Taiwan, South Korea and Israel to point up the economic and strategic stakes--and the complexity--of effective policy toward the ADC's.

c) Among the mid-level LDC's there are several with potential to move into the advanced group in the 1980's, and others (such as Pakistan) will be of major strategic importance even though they are unlikely to prosper as much. Although for most of the mid-level countries the need for multilateral and bilateral assistance will remain large, in a few of the faster growing ones the tools of export promotion and of investment guarantees could become increasingly important for the U.S. Many are also dependent on raw material exports and continue to suffer from sharp fluctuations in certain world commodity prices which destabilize their balance of payments and frustrate balance of payments planning efforts.

These countries also urgently need to improve their export performance and are concerned about protectionist pressures on developed country governments. As their export sectors develop, GSP could become an increasing factor in relations with some of these countries, particularly if ways can be found to mitigate the impact on troubled U.S. domestic industries. Both for trade and for development assistance, "graduation" will be important, especially in freeing for them resources now flowing to the ADC's and, in the longer term, in reallocating assistance within the middle group. Particularly relevant will be moves from soft to hard-loan windows and greater reliance on the IMF and on commercial financing and private investment. Debt problems will be especially acute for some of the mid-level LDC's during the 1980's and our rescheduling policy will face continuing challenges.

On the supply side, this group of LDC's is likely to become increasingly important to the U.S. as a source of energy and other primary products or their derivatives.

(d) Low income LDC's (LLDC's), with a few exceptions, present less strategic and economic importance to the U.S. and less short-term development potential. Assuming that we wish to assist on political, humanitarian or other grounds, the need for concessional assistance will be great and IDA and the other MDB soft-loan windows will have a major role, and the chances for increased aid from other donors may also be greater for this group. Although LLDC markets will be small in the 1980's a few individual countries will be important to us in terms of raw materials sourcing, of immigration pressures, of base rights, or for other political or military reasons.

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U.S./LDC Trade

US Imports, 1979 ($Billion)		%
Total (all sources)	207.13	100.0
All LDCs	92.42	44.6
Oil exporters	48.7	23.5
Non-oil LDCs	43.7	21.1

US Exports, 1979 ($Billion)		%
Total (all sources)	181.8	100.0
LDC	63.0	34.6
Oil exporters	15.1	8.3
Non-oil LDCs	47.9	26.3

US Imports under GSP from Principal Beneficiaries

	1979 Amount GSP duty free ($m.)	Percent of Total US GSP
Taiwan	$1,721	27%
Korea	750	12%
Hong Kong	629	10%
Mexico	546	9%
Brazil	546	9%
Israel	283	5%
Singapore	232	4%
Yugoslavia	166	3%
India	137	2%
Philippines	137	2%
	$5,147	83%

LDC Global Trade 1978 ($Billion)*

	Exports	Imports
Low income	29	32
Middle income	180	232
Total non-oil	209	264
Oil surplus	94	50
Total	303	314

*1979 figures not readily available